17 JUL 1978

Executive Registry
78-1763/3

OGC 78-4563
7-13-78

DD/A Registry
78-2042/8

STATINTL

1. What would it take for us to do it [redacted] had we had these clauses?

2. Why not all DCI contracts not just CIA?

3. Memo to me and FY puts pressure on contractors to accept our clauses or lose contract

13 JUL 1978

DD/A Registry
File Contracts

MEMORANDUM FOR: Director of Central Intelligence

VIA: Deputy Director of Central Intelligence

FROM: John F. Blake
Deputy Director for Administration

SUBJECT: Security Provisions in Agency Contracts

REFERENCE: Memo dtd 16 Jun 78* to DCI fm DDA; same subject (DDA 78-2042/4; OL 8 2541b)

OGC Has Reviewed

1. Action Requested: That you approve the approach outlined in this memorandum, which deals with security requirements in Agency contracts, and that you approve the two attached contract clauses.

2. Background: In our view the attached contractual provisions represent the only viable alternative to the existing scheme so far as concerns the protection and enforcement of the Agency's security interests during the performance of Agency contracts. They detail a contractor's obligation regarding security and the remedies available to the Government when the former fails to adhere to those obligations. The first provision, entitled "Security Requirements," incorporates into the contract the documents which establish the terms and conditions for security. The second clause, entitled "Special Provisions Regarding Security and Non-Publicity," states in unequivocal language that the security and non-publicity provisions of the contract go to the essence of the overall agreement. This language is considered necessary, because in order to invoke termination for default, it must be established that the basis for the action stems from a failure to perform part of the contract which goes to the heart of the agreement. It is recognized that the clauses do not permit a summary penalty to be imposed, such as a fine or other forfeiture. As

must be the case, the clauses come into play as a condition of performance rather than on the basis of strict liability. The latter standard imposes a denial of due process which is unconstitutional. The provisions, nonetheless, are tough and greatly strengthen the Agency's hand. It is important to note that the approval of using award fee contracts still remains available where applicable. This type of contract enables the contracting officer to reduce the fee under those circumstances where security deficiencies warrant action less than an absolute termination. The use of this type contract has been outlined separately in referent and will not be discussed in detail here. It is emphasized that an award fee contract in actuality permits the Government to reduce the contractor's fee (profit) based upon his performance as determined by the contracting officer. The quality of security could be one such factor in this determination. It is not a reward or bonus for merely doing that which a contractor is required. Instead, it forces performance at the risk of having profit reduced by the contracting officer. The award fee contract, while a meaningful management tool, however, does not fit every situation. In addition, it is very difficult and costly to administer.

3. A device which was considered and appeared to offer more immediate clout to the Agency in this regard is a requirement for a contractor to post a bond to ensure adequate security measures are implemented. The theory behind this is, if the contractor falls below a definitive, unambiguous standard, one which must be promulgated in the forthcoming security manuals, the bond "would be called" and a sum forfeited to the Government. Bonds of this nature generally fall into two categories. They are either for payment or performance and usually have a statutory basis rather than originating from the contract terms alone. The bonds required by the Miller Act for public works construction (40 U.S.C. 270a) are a good example. That Act requires of contractors both a payment and a performance bond. The purpose of the payment bond is to ensure payment of laborers and materialmen while the performance bond protects the Government by ensuring performance of the contract. A payment bond because of its purpose is not applicable to the current problem. The performance referred to in a performance bond has to be capable of objective measurement; i.e., finished units, completed construction, etc. In such cases the contracting officer can determine the rate and extent of performance being

made. Security performance does not lend itself to that degree of objective measurement. While the final result of such performance, however, is objective in that a project is either compromised or not, the measurement of how securely a contract is being performed is itself subjective. Furthermore, a bond is called only after a default has occurred and the surety must be given a chance to complete performance before forfeiting the sum. Basic to this concept is the idea that the contractor is not performing in the traditional sense, and the Government will not otherwise get its deliverable end item in a timely fashion. Finally, if the surety disagrees with the contracting officer's determination, it declines to pay and suit must be initiated. For these reasons, a performance bond requirement for security enforcement is not feasible. Moreover, because of the uniqueness and uncertainty involved, it is doubtful if a commercial surety could be found.

4. The use of a fidelity bond has been considered but such an instrument runs to an individual and not to corporate entities. This type of bond provides a guaranty of personal honesty by furnishing indemnity against negligence. In a similar vein, fidelity insurance provides a guaranty of the fidelity of an officer, agent, or employee of the assured, or rather to indemnify the latter for losses caused by dishonesty on the part of such person. The client, or customer, whose account has been adversely affected cannot call the bond or make demand upon an insurance carrier because he is not the beneficiary. This type of protection is clearly intended to minimize losses due to theft. It suffers the same deficiencies as does the performance bond.

5. Another technique examined was the use of a liquidated damages clause. This provision is typically used when there is true mutual agreement in a contract for the amount of the damages the Government will receive if completion and delivery are delayed. These damages must be authorized by contract clause. The basic requirements for a valid liquidated damages provision expressed in the Restatement of Contracts, published in similar language in the Armed Services Procurement Regulations (ASPR 1-310) and recognized by the Supreme Court, are:

> An agreement made in advance of breach, fixing the damage therefor, is not enforceable as a contract and does not affect the damages recoverable for the breach, unless

(a) the amount so fixed is a reasonable forecast of the just compensation for the harm that is caused by the breach, and

(b) the harm that is caused by the breach is one that is incapable or very difficult of accurate estimation.

6. At first impression one may conclude that the use of liquidated damages would be an ideal tool but, in fact, such a clause has prompted far more than its share of litigation.. The fundamental justification of any liquidated damage provision is the difficulty of estimating in advance the probable financial impact of breach of contract. However, where it seems that compensation is not the object of the liquidated damages clause, but its insertion into the contract is intended as a weapon to compel performance, the courts have regarded that clause as calling for a penalty and declined to enforce it. It has long been held that any liquidated damage provision is a deterrent against performance failure. If the main purpose of the clause, however, is to hold one "in terrorem," a spur to performance as such, rather than to compensate the injured party for its loss in case of breach, the courts hold that the provision calls for the imposition of a penalty; hence, it is not enforceable. What makes a penalty unenforceable, absent a statutory basis and meaningful chance to rebut the alleged deficiency, is that it would amount to an unconstitutional deprivation of property without due process. We have an inherent right to measurable damages but not to penalties.

7. It should be noted that a paper was submitted to the Task Force which addressed the topic of possible imposition of penalties for noncompliance with security standards and procedures. The conclusion reached in that paper indicated there would be great difficulty in fashioning a clause that would be a legally valid and effective means of penalizing an Agency contractor for security delinquencies that might occur during the course of contract performance. We find no basis under current procurement law to support the use of a penalty clause.

8. Recommendation: In view of the foregoing, it is recommended that you approve the attached clauses for implementation in all contracts issued by the Central Intelligence Agency.

SUBJECT: Security Provisions in Agency Contracts

However, since the attached clauses have never been used in Government contracts and it cannot be said with certainty that industry will accept them as written, it is proposed that implementation be effective on new procurements only and not become mandatory until FY 79. This will permit time to assess industry acceptance or reaction and, in the event of adverse reaction, will not delay procurements made at the end of FY 78.

/s/John F. Blake
John F. Blake

Att

CONCURRENCE:

/s/ Anthony A. Lapham
Anthony A. Lapham
General Counsel

12 JUL 1978
Date

APPROVED: /s/ Stansfield Turner
Director of Central Intelligence

DISAPPROVED: _____
Director of Central Intelligence

DATE: 25 AUG 1978

Distribution:
Orig - Return to L&PLD/OGC via DDA (Official)
1 - DCI
1 - DDCI
1 - GC
1 - ER
2 - DDA Subject

SUBJECT: Security Provisions in Agency Contracts

STATINTL

ORIGINATORS:

[redacted]

11 July 78
Date

STATINTL [redacted]
DEG/OD&E/DDS&T

[redacted]

11 July 78
Date

Logistics & Procurement Law Div.
Office of General Counsel

Distribution Withheld:

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STATINTL OL/L&PLD/[redacted] (11 July 1978)

SECURITY REQUIREMENTS

(a) The Contractor shall maintain a Security Program in accordance with the requirements of _____ _____ which are incorporated herein and made a part hereof. These security provisions are basic to the performance of this Contract and represent an essential element of the overall agreement between the parties.

(b) The Contractor shall not initiate or perform any classified work in the Contract until he is in compliance with the security provisions incorporated herein and has received written approval to proceed from the Contracting Officer.

SPECIAL PROVISIONS REGARDING SECURITY AND NON-PUBLICITY

(a) It is agreed and understood that the security and non-publicity provisions of this contract go to the essence of the overall agreement between the Government and the contractor, hence, the contractor shall maintain and administer, in accordance with industrial security manuals and agreements incorporated in the schedule of this contract, a security program which meets the requirements of these documents.

(b) Reference is made to the article of the General Provisions entitled "Default" ("Termination"). It is agreed and understood that failure of the contractor to maintain and administer a security program, fully compliant with the security requirements of this contract, constitutes grounds for termination for default.

(c) Specifically, the contract is subject to immediate default, without the requirement of a 10-day cure notice, where it has been determined by the contracting officer that failure to fully comply with the security requirements of the contract results from willful misconduct or lack of good faith on the part of any one of the contractor's directors or officers, or on the part of any of his managers, superintendents, or other equivalent representatives who have supervision or direction of:

(1) All or substantially all of the contractor's business, or

(2) All or substantially all of the contractor's operations at any one plant or separate location in which this contract is being performed, or

(3) A separate and complete major industrial operation in connection with the performance of this contract.

(d) Where deficiencies in the contractor's security program are noted, the contractor shall be provided a written notice of these deficiencies and given a period of 10 days to take corrective action. If the contractor fails to take the necessary corrective action, the Government may terminate the whole or any part of this contract for default.

(e) Reference is made to Article 24 of Section A of the General Provisions entitled "Non-Publicity." Violation of the terms and conditions of this clause, if classified information is divulged, constitutes a major breach of contract and the contract may be terminated immediately for default without the requirement of a 10-day cure notice.

16 June 78

MEMORANDUM FOR: Director of Central Intelligence

VIA: General Counsel

FROM: John F. Blake
Deputy Director for Administration

SUBJECT: Security Provisions in Agency Contracts

REFERENCES: (a) Memo to DCI, dtd 1 Jun 78, fm DDA, no subject (DD/A 78-2042/1)

(b) Memo to DDA, dtd 6 Jun 78, fm DCI, Subject: Contracting Procedures on Security (ER 78-1465/3)

1. Reference (a) was an update on the status of actions we are taking in the area of industrial security. Reference (b) indicated your concern with the development of a "performance clause" which would subject a contractor to penalties in the event of a leak of security information.

2. It appears that we are involved in uncharted waters when we attempt to use a penalty approach in Government contracting to enforce security requirements. While we can say with absolute certainty that a contractor is contractually required to meet all the security requirements of his contract, the legal mechanisms to enforce performance have not been tested by Boards of Contract Appeals or in the Courts. The Office of General Counsel has found no cases in which a contract has been terminated for default based upon a violation of security.

3. The legal bases for attributing the acts of an agent (employee) to his principal (contractor) are well established in Government contracting. If a contractor cumulatively fails to live up to the standard of duty required in: (1) the selection of the employee who is given access to classified information; (2) the method of training of that employee; (3) the method and character and intensity of supervision of that employee; and, (4) enforcement of the contractor's own policy and procedures

with respect to handling classified material, his liability for the employee's actions can be affixed under the heading of either lack of good faith or willful misconduct. The burden of proof in this regard would be with the Government. Inasmuch as we approve the contractor's security procedures and grant approvals for persons to be given access to classified data, the possibility for our shifting the total responsibility to the contractor for a breach of contract for a security violation by one of his employees is rather remote.

4. Specific contract penalties, outside the very drastic step of termination for default, are also difficult to assess. The Task Force on Industrial Security and Industrial Contracting in Recommendation No. 17 of its Interim Report suggested "That incentive award fee type contracts include security performance along with other performance requirements as a basis for fee determination." This concept, which you approved, can be implemented to provide reward/penalty for various levels of contractor performance. While there are reasons other than profit on an instant contract which motivate a contractor to do a good job, a portion of an award fee, associated with security, could provide a meaningful incentive to a contractor. The rewards and penalties (profit and loss) that a contractor earns on other than cost-plus-award-fee (CPAF) contracts are based on objective measurements in terms of cost, performance, and schedule. The introduction of a subjective or even objective measure for reward or penalty, based upon security, would probably not provide a meaningful incentive to a contractor unless a preponderance of fee or profit was associated with it. This then could become counterproductive to the incentive placed on operational and funding aspects of the contract. Such an incentive would also be difficult, if not impossible, to administer and measure.

5. Attached hereto is a proposed contract article entitled, "Special Security Provisions" which highlights the importance we place on security in performance of the contract and sets forth the penalty a contractor is subject to in the event he fails to comply therewith. It should be noted that this article makes more specific certain rights which are inherent in the "default" and "termination" provisions of Government contracts. However, the article does include some language which may go too far in attributing the action of a contractor's employee

SUBJECT: Security Provisions in Agency Contracts

to the contractor. Because we are, in effect, creating new contract provisions and inserting language which is not a part of existing procurement regulations, we have asked General Counsel to provide his comments on the enforceability and effectiveness of these provisions for your consideration, prior to implementation. Additionally, we should give consideration to soliciting industry comments in order to test acceptance of our contractors, which could possibly result in some beneficial suggestions.

[redacted] STATINTL

John F. Blake

Att

Distribution:
Orig - DCI
1 - DDCI
1 - ER

1 cy ea - 10/02 D/OS

OGC 78-5508

22 August 1978

MEMORANDUM FOR: Director of Central Intelligence

VIA: Deputy Director of Central Intelligence

FROM: Anthony A. Lapham
General Counsel

SUBJECT: Proposed Security Clauses in Contracts

REFERENCES:

a. Your memorandum dated 8 Aug 78, same subject (ER 78-1465-7)

b. Memorandum to you from DDA dated 13 July 78, subject: Security Provisions in Agency Contracts (ER 78-1465/5, DDA 78-2042/8, OGC 78-4563)

c. Memorandum to you from DDA dated 16 Jun 78, same subject (DDA 78-2042/4, OL 8 2451b)

1. Action Requested: That you approve the two security clauses and the manner of implementation recommended by the DDA in his July 13 memorandum (reference b).

2. Background: Your 8 August memorandum restates your objective of establishing a standard of absolute contractor liability in relation to security matters. That is, as I understand it, your idea is that contractors should be held strictly to account, and be subject to penalty, for any lapses in security that may occur during contract performance, whether or not those lapses ae attributable to a failure on the contractor's part to adhere to required security practices and procedures. Under such a scheme, for example, in the event of another Boyce case, it would be enough to show in order to exact some sanction from the contractor that the employee involved in fact had compromised some classified information to which he had access in the contractor's facilities. It would not be necessary to show that the compromise came about because of the contractor's failure to maintain proper access controls, or to provide for the secure storage of documents in a prescribed manner, or to comply with any other specific security requirement.

3. This Office was instrumental in developing the recommendations contained in the DDA's 13 July memorandum. While those proposals will not accomplish the objective that you have in mind, they will extend and clarify contractor obligations with respect to security and enhance our position when it comes to the enforcement of those obligations.

4. We struggled to get as close to your objective as we could. If it were to be reached, however, the contractors would be exposed to liability in circumstances in which they had performed in exact accordance with every specific security requirement in their contracts, or even had exceeded those requirements. In my view any provisions that set up this possibility would be unacceptable to contractors as a practical matter and invalid as a legal matter. Penalty provisions of this sort are simply impermissible, and especially must that be the case in the area of security where so much of what happens is a shared responsibility (e.g., we clear the employees, approve the facilities, prepare the manuals, etc.).

5. As I see it the only permissible approach, reflected in the pending recommendations, is to indicate more clearly what security practices and procedures we expect contractors to follow, to make certain our requirements are incorporated into contracts, and to more closely monitor contractor performance. If a compromise then occurs, despite full contractor compliance with our requirements, I can find no legal justifiable way to exact damages or penalties.

STATINTL

6. Recommendation: See paragraph 1.

[redacted]

Anthony A. Lapham

cc: DDA

8 AUG 1978

MEMORANDUM FOR: General Counsel

FROM: Director of Central Intelligence

SUBJECT: Proposed Security Clauses in Contracts

1. Attached is a memo from Jim McDonald, dated 25 July, on the question of what security clauses we can put in our contracts in order to inhibit Boyce/Lee-type events. Please note in paragraph 3a Jim describes what we would have been able to do against TRW had we had these new clauses in their contracts prior to the Boyce/Lee revelations. As I read paragraph 3a, it's not very much, perhaps defaulting the whole or a part of the contract--probably more than we would be willing to do in the circumstances.

2. Perhaps this is the best we can establish. I still feel very frustrated that we can't find some legal way simply to say to a chap, "When you have been proven guilty by a court of law of allowing people to steal secrets from your plant, you will be punished." It surely seems to me there must be at least some such standard that we can establish which can be readily verified as constituting noncompliance.

STATINTL

[redacted]

STANSFIELD TURNER

cc: DDCI
DDA

Attachment

OGC 78-4962
7-28-78

25 July 1978

MEMORANDUM FOR: Director of Central Intelligence

VIA: Deputy Director of Central Intelligence
Deputy Director for Administration
General Counsel

FROM: James H. McDonald
Director of Logistics

SUBJECT: Response to DCI Questions Regarding the Proposed Security Clauses

REFERENCE: Memo dtd 13 Jul 78 to DCI fm DDA; Subject: Security Provisions in Agency Contracts (DDA 78-2042/8; OL 8 3196)

1. Action Requested: None; for information only.

2. Background: This memorandum is prepared in response to three questions you asked concerning referent security provisions. The questions were:

a. "What would we have been able to do to TRW had we had these clauses?"

b. "Why not all DCI contracts--not just CIA?"

c. "Seems to me end of fiscal year puts pressure on the contractors to accept our clauses or lose contract."

3. Staff Position:

a. In reply to the first question, the clauses assist us in three ways which would have enhanced the possibility of sustaining a termination for default. First, they provide a more definitive standard for the requirements of industrial contract security. In this sense, they can be regarded as one would view "tightening of specifications." Secondly, the strict adherence to these provisions are expressly made part of the essence of the contract bargain. The publication of new industrial security manuals, which it is expected will contain clearer and more definitive standards and requirements for contractors, in conjunction

with the clauses that incorporate the manuals into all contracts placed by the Agency produces a third benefit; namely, a better ability to tie in security practices with contract performance itself. While these new clauses would not give us any remedies except insofar as we might be able to show that a contractor had failed to live up to the contract standards of performance in relation to security -- that is, while there would be no per se rule under which a contractor might be penalized merely on the basis of a compromise of the Boyce/Lee variety, without reference to compliance or non-compliance with the security requirements specified in the contract -- they would put muscle into our prospects for sustaining a default termination which could not have been accomplished against TRW as circumstances then existed.

b. In response to the second question, it is assumed that all DCI contracts means all contracts let by the intelligence community members. As DCI, you get contracting authority by virtue of being head of the Central Intelligence Agency (50 U.S.C. 403). In particular, the Section 3(b) of the CIA Act pertaining to procurement authorities states:

> "In the exercise of the authorities granted in subsection (a) of this section (selected procurement provisions from the Armed Services Procurement Act), the term "Agency head" shall mean the Director, the Deputy Director, or the Executive of the Agency."

While the power of executive departments to contract is implied as a necessary incident to the proper performance of public duties, the DCI authority to contract does not extend to the other members of the intelligence community. More importantly, the intelligence community is not a separate executive agency, as the term is defined in 5 U.S.C. 105. Further, the duties prescribed for the DCI in 1-601 and 1-602 of Executive Order 12036 do not expand the contracting authority of the DCI beyond the Central Intelligence Agency. However, as DCI you may request that the heads of intelligence community agencies direct the implementation of these clauses in their respective contracts. We would suggest, however, that such action be held in abeyance until CIA determines the acceptability by industry of the clauses.

c. In order to properly answer the last question, it must be recognized that end of fiscal year pressure is

SUBJECT: Response to DCI Questions Regarding the Proposed Security Clauses

in reality two edged. Industry's acceptance of the clauses cannot be assured as previously noted. Agency funds are treated as annual appropriations. This requires that monies for its procurements be obligated before the end of the fiscal year. Failing this, the funds are said to "expire" in that they are no longer available for obligation of annual appropriations. Hence, should they decline to accept the revised clauses or elect to engage in prolonged arguments over acceptability, the Agency's ability to obligate its monies would be severely limited. The end of FY 78 is rapidly approaching. Should the Agency fail to meet the fiscal year deadline for obligations, the result would be budgetary chaos. The introduction of the new security clauses at this juncture in the fiscal year jeopardizes timely completion of the contracting process. We must have reasonable time to test the acceptability of these clauses before we make their use mandatory.

4. We feel it necessary to conclude by noting that the Congress has not given the CIA the rule-making power, such as found in charters or statutes pertaining to the various regulatory agencies. We do not enforce statutes as does E.P.A., I.C.C., or the like. Obviously, this is because our missions are different. Regulatory agencies are provided by the Congress with carefully drafted charters enabling them to make rules and, in certain instances, impose a sanction, such as a fine for a breach. While it would be attractive to impose a sanction, such as monetary fine rather than termination of all or part of a contract, the Agency does not have that authority.

/s/ James H. McDonald

James H. McDonald

Distribution:
Orig - DCI
1 - DDCI
1 - ER
1 - GC
2 - DDA

17 JUL 1978

1. What would be possible if [redacted] had not had these clauses?

STATINTL

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MEMORANDUM FOR: Director of Central Intelligence

VIA: Deputy Director of Central Intelligence

FROM: John F. Blake
Deputy Director for Administration

SUBJECT: Security Provisions in Agency Contracts

REFERENCE: Memo dtd 16 Jun 78* to DCI fm DDA; same subject (DDA 78-2042/4; OL 8 254

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SUBJECT: Security Provisions in Agency Contracts

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(b) the harm that is caused by the breach is one that is incapable or very difficult of accurate estimation.

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SUBJECT: Security Provisions in Agency Contracts

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Signed: John F. Blake

John F. Blake

Att

CONCURRENCE:

/s/ Anthony A. Lapham — 12 JUL 1978

Anthony A. Lapham
General Counsel — Date

APPROVED: _____
Director of Central Intelligence

DISAPPROVED: _____
Director of Central Intelligence

DATE: _____

Distribution:
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SUBJECT: Security Provisions in Agency Contracts

STATINTL ORIGINATORS:

[redacted] 11 July 78
Date

for STATINTL Contracting Officer
DEG/OD&E/DDS&T

[redacted] 1 July 78
Date

Logistics & Procurement Law Div.
Office of General Counsel

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1 - OL Files
1 - D/L Chrono

STATINTL OL/L&PLD/[redacted] (11 July 1978)

ATTACHMENT

SECURITY REQUIREMENTS

(a) The Contractor shall maintain a Security Program in accordance with the requirements of _____ _____ which are incorporated herein and made a part hereof. These security provisions are basic to the performance of this Contract and represent an essential element of the overall agreement between the parties.

(b) The Contractor shall not initiate or perform any classified work in the Contract until he is in compliance with the security provisions incorporated herein and has received written approval to proceed from the Contracting Officer.

SPECIAL PROVISIONS REGARDING SECURITY AND NON-PUBLICITY

(a) It is agreed and understood that the security and non-publicity provisions of this contract go to the essence of the overall agreement between the Government and the contractor, hence, the contractor shall maintain and administer, in accordance with industrial security manuals and agreements incorporated in the schedule of this contract, a security program which meets the requirements of these documents.

(b) Reference is made to the article of the General Provisions entitled "Default" ("Termination"). It is agreed and understood that failure of the contractor to maintain and administer a security program, fully compliant with the security requirements of this contract, constitutes grounds for termination for default.

(c) Specifically, the contract is subject to immediate default, without the requirement of a 10-day cure notice, where it has been determined by the contracting officer that failure to fully comply with the security requirements of the contract results from willful misconduct or lack of good faith on the part of any one of the contractor's directors or officers, or on the part of any of his managers, superintendents, or other equivalent representatives who have supervision or direction of:

(1) All or substantially all of the contractor's business, or

(2) All or substantially all of the contractor's operations at any one plant or separate location in which this contract is being performed, or

(3) A separate and complete major industrial operation in connection with the performance of this contract.

(d) Where deficiencies in the contractor's security program are noted, the contractor shall be provided a written notice of these deficiencies and given a period of 10 days to take corrective action. If the contractor fails to take the necessary corrective action, the Government may terminate the whole or any part of this contract for default.

(e) Reference is made to Article 24 of Section A of the General Provisions entitled "Non-Publicity." Violation of the terms and conditions of this clause, if classified information is divulged, constitutes a major breach of contract and the contract may be terminated immediately for default without the requirement of a 10-day cure notice.

Approved For Release 2002/05/07 : CIA-RDP81-00142R000200010001-1

16 June 78

MEMORANDUM FOR: Director of Central Intelligence

VIA: General Counsel

FROM: John F. Blake
Deputy Director for Administration

SUBJECT: Security Provisions in Agency Contracts

REFERENCES: (a) Memo to DCI, dtd 1 Jun 78, fm DDA, no subject (DD/A 78-2042/1)

(b) Memo to DDA, dtd 6 Jun 78, fm DCI, Subject: Contracting Procedures on Security (ER 78-1465/3)

1. Reference (a) was an update on the status of actions we are taking in the area of industrial security. Reference (b) indicated your concern with the development of a "performance clause" which would subject a contractor to penalties in the event of a leak of security information.

2. It appears that we are involved in uncharted waters when we attempt to use a penalty approach in Government contracting to enforce security requirements. While we can say with absolute certainty that a contractor is contractually required to meet all the security requirements of his contract, the legal mechanisms to enforce performance have not been tested by Boards of Contract Appeals or in the Courts. The Office of General Counsel has found no cases in which a contract has been terminated for default based upon a violation of security.

3. The legal bases for attributing the acts of an agent (employee) to his principal (contractor) are well established in Government contracting. If a contractor cumulatively fails to live up to the standard of duty required in: (1) the selection of the employee who is given access to classified information; (2) the method of training of that employee; (3) the method and character and intensity of supervision of that employee; and, (4) enforcement of the contractor's own policy and procedures

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SUBJECT: Security Provisions in Agency Contracts

with respect to handling classified material, his liability for the employee's actions can be affixed under the heading of either lack of good faith or willful misconduct. The burden of proof in this regard would be with the Government. Inasmuch as we approve the contractor's security procedures and grant approvals for persons to be given access to classified data, the possibility for our shifting the total responsibility to the contractor for a breach of contract for a security violation by one of his employees is rather remote.

4. Specific contract penalties, outside the very drastic step of termination for default, are also difficult to assess. The Task Force on Industrial Security and Industrial Contracting in Recommendation No. 17 of its Interim Report suggested "That incentive award fee type contracts include security performance along with other performance requirements as a basis for fee determination." This concept, which you approved, can be implemented to provide reward/penalty for various levels of contractor performance. While there are reasons other than profit on an instant contract which motivate a contractor to do a good job, a portion of an award fee, associated with security, could provide a meaningful incentive to a contractor. The rewards and penalties (profit and loss) that a contractor earns on other than cost-plus-award-fee (CPAF) contracts are based on objective measurements in terms of cost, performance, and schedule. The introduction of a subjective or even objective measure for reward or penalty, based upon security, would probably not provide a meaningful incentive to a contractor unless a preponderance of fee or profit was associated with it. This then could become counterproductive to the incentive placed on operational and funding aspects of the contract. Such an incentive would also be difficult, if not impossible, to administer and measure.

5. Attached hereto is a proposed contract article entitled, "Special Security Provisions" which highlights the importance we place on security in performance of the contract and sets forth the penalty a contractor is subject to in the event he fails to comply therewith. It should be noted that this article makes more specific certain rights which are inherent in the "default" and "termination" provisions of Government contracts. However, the article does include some language which may go too far in attributing the action of a contractor's employee

SUBJECT: Security Provisions in Agency Contracts

to the contractor. Because we are, in effect, creating new contract provisions and inserting language which is not a part of existing procurement regulations, we have asked General Counsel to provide his comments on the enforceability and effectiveness of these provisions for your consideration, prior to implementation. Additionally, we should give consideration to soliciting industry comments in order to test acceptance of our contractors, which could possibly result in some beneficial suggestions. STATINTL

[redacted]
John F. Blake

Att

Distribution:
Orig - DCI
1 - DDCI
1 - ER

UNCLASSIFIED | CONFIDENTIAL | SECRET

OFFICIAL ROUTING SLIP

TO	NAME AND ADDRESS	DATE	INITIALS
1	Acting Director of Logistics		
2	[redacted]		
3			
4			
5			
6			

	ACTION		DIRECT REPLY		PREPARE REPLY
	APPROVAL		DISPATCH		RECOMMENDATION
	COMMENT		FILE		RETURN
	CONCURRENCE		INFORMATION		SIGNATURE

Remarks:

Hal,
DCI has finally approved the new security provisions for contracts. It is now your action.

FOLD HERE TO RETURN TO SENDER

[redacted]

DATE
29 AUG 1978

UNCLASSIFIED | SECRET

FORM NO. 1-67 237 (40)

STATINTL

STATINTL

DDA:JFBlake:kmg (29 Aug 78)
Distribution:
Orig RS - AD/Log w/Orig of Att (DDA 78-2042/8)
~~1~~ - DDA Subj
1 - DDA Chrono
1 - JFB Chrono
Att: Memo dtd 13 Jul 78 to DCI via DDCI fr DDA, subj: Security Provisions in Agency Contracts (DDA 78-2042/8)

"Hal,
"DCI has finally approved the new security provisions in agency contracts. It is now your action!
/s/Jack Blake"